

Board of Governors of the Federal Reserve System

**REPORT ON THE AUDIT OF
THE BOARD'S ACADEMIC
ASSISTANCE PROGRAM**



OFFICE OF INSPECTOR GENERAL

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EXECUTIVE SUMMARY

Background

The Board has an academic assistance program to provide financial assistance to employees taking courses related to their current jobs or other jobs at the Board. The program is intended not only to help current employees become more valuable, knowledgeable, and productive, but also to assist in attracting and recruiting new employees. The Human Resources function (HR) within the Management Division is responsible for managing and administering the program, which includes ensuring that it operates efficiently and effectively and adheres to relevant laws and regulations.

Audit Purpose

We performed this audit to assess the adequacy of internal controls over the Board's academic assistance program. The audit was initiated because of conditions found during our ongoing partnership effort with HR to review the Board's training and career development program.

Results

Overall, we found that the academic assistance program lacks an effective system of internal controls. As a result, the Board has little assurance that the program:

- achieves its objective of providing financial assistance for Board-related courses to enhance employee work performance and career development,
- complies with applicable laws and regulations, and
- expends funds for the intended purposes and in accordance with Board policy.

We have designated an estimated \$409,000, or just over 50 percent of the academic assistance funds expended during 1997 and through August 1998, as questioned costs, because we believe that tax determinations for these amounts may not have been consistent with federal internal revenue laws and regulations. Furthermore, while we did not identify specific instances of fraud and abuse, management should not rely on the current system to prevent, detect, or correct errors or irregularities. Problems with the academic assistance program have been known for some time; internal reviews performed as far back as the early 1980s described internal control weaknesses that continue to exist today. While the changes that HR made in response to past reviews may have resulted in short-term improvements, they were insufficient to ensure that the program achieved its objectives over the longer term in a well-controlled manner. The HR Associate Director has begun taking steps to strengthen controls in some areas; however, sustained management oversight and

supervision will be needed to provide an effective and efficient internal control framework for the Board's academic assistance program.

Our report provides ten recommendations designed to establish an internal control framework for the academic assistance program. First, we recommend that the program be brought into compliance with internal revenue laws and regulations by conducting a case-by-case review of academic assistance payments to determine their taxability. The next eight recommendations focus on establishing controls over the academic assistance approval, processing, and reporting functions. Our final recommendation focuses on defining and communicating clear roles and responsibilities; establishing internal operating procedures; and providing sustained oversight, supervision, and training to ensure that policies and procedures are effectively implemented.

Analysis of Comments

We provided copies of this report to the Staff Director for Management and the General Counsel for their review and comment. The staff director concurs with each of the ten recommendations and expects to implement the associated changes no later than April 1, 1999, with the possible exception of changes to, or the replacement of, the current automated tracking system should that be necessary (see appendix 1, page 27). The General Counsel's response, which specifically addresses recommendations 1 and 2, indicates general agreement with both recommendations (see appendix 2, page 31). The General Counsel also notes that the Legal Division has been working with the Management Division and has identified situations involving taxable income for 1998, which the Management Division is endeavoring to resolve. The Legal Division is also considering how far back in time the review should go and what specific steps need to be taken to resolve any pre-1998 taxability issues that may arise. Finally, the Legal Division is working with the Management Division on revising the "Academic Assistance Policy" and forms.

BACKGROUND

The Board of Governors of the Federal Reserve System (the Board) maintains an academic assistance program to encourage and assist employees in improving their effectiveness, enhancing their career potential, and furthering their self-development. Under this program, the Board provides financial assistance to employees taking academic courses related to their current jobs or other jobs at the Board, including, as appropriate, courses that are part of job-related degree programs. The Board views the program as a benefit that not only helps current employees become more valuable, knowledgeable, and productive but also aids in attracting and recruiting new employees.

The level of participation in the academic assistance program has been fairly steady over the past four years. Table 1 gives an overview of the annual academic assistance expenditures and participation levels from 1995 through August 15, 1998.

Table 1: Academic Assistance Expenses and Participation, 1995 through 1998¹

Year	Expenses	Number of Participants
1995	\$462,720	161
1996	\$433,040	149
1997	\$440,659	175
1998 ²	\$360,793	125

Program Management and Administration

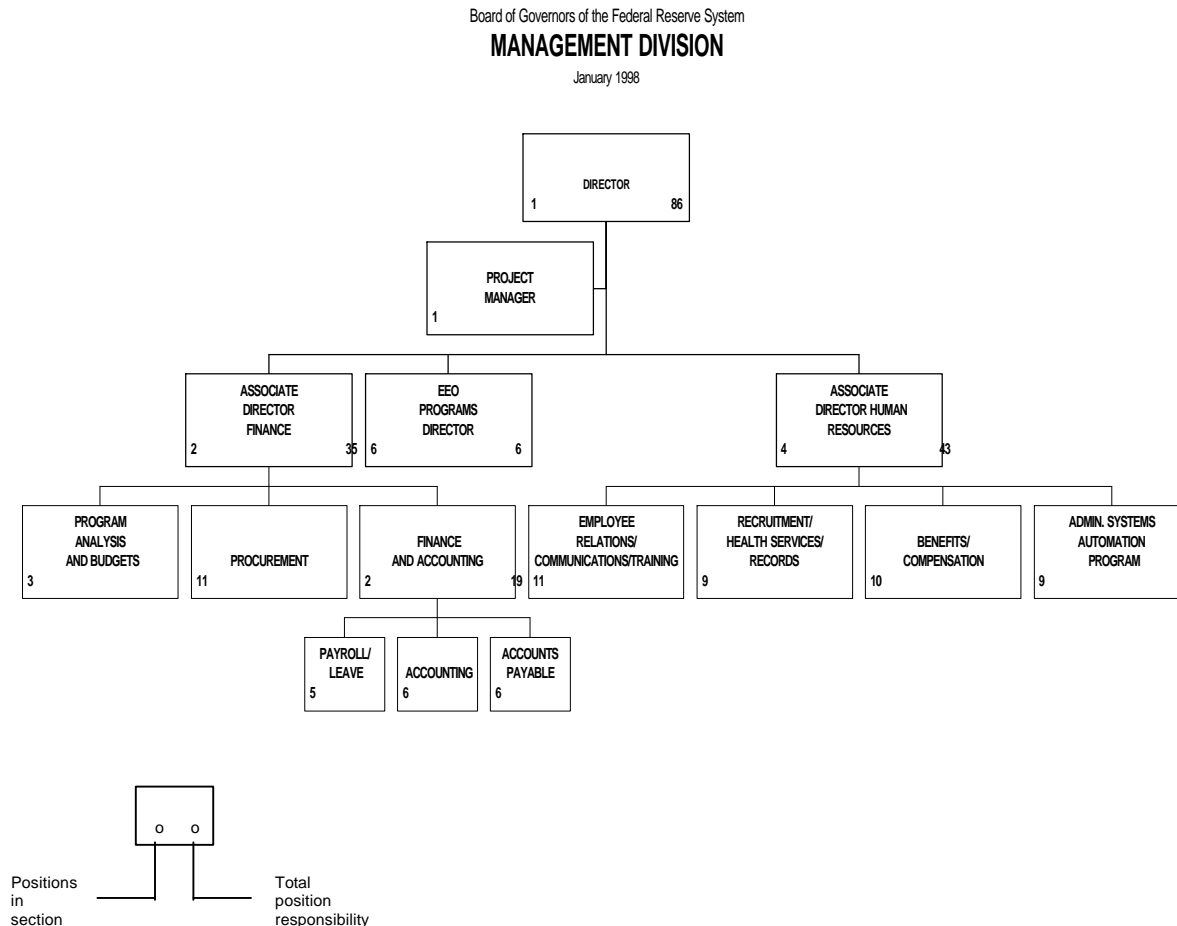
In January 1998, the Board centralized certain administrative functions by merging the previous Office of the Controller with the Human Resources Management Division to establish the Management Division (see figure 1 for the current organization chart). The Staff Director for Management, who also serves as the Director of the Management Division, issues the “Academic Assistance Policy,” which communicates the general principles and guidelines for participants in the academic assistance program.³

¹Because the Human Resources function (HR) and the Finance function (Finance) maintain separate files on academic assistance and neither file provides a complete record of key events or decisions, this table includes expense data from Finance records and participation numbers from HR records.

² Year-to-date expenditure and participation levels as of August 15, 1998.

³ The “Academic Assistance Policy” (a part of the Board’s *Internal Administrative Procedures Manual*) was updated in April 1998, primarily to include general principles regarding the taxability of academic assistance. With a few other minor revisions, the previous policy statement dated July 26, 1993, remained unchanged.

Figure 1: Management Division Organization Chart



The Human Resources function (HR) of the Management Division administers the academic assistance program, with the Manager for Employee Relations, Communications, and Training as the academic assistance program manager. A training specialist serves as the program administrator and handles day-to-day operations, which include interpreting policy, providing guidance and counseling to Board staff, reviewing academic assistance registration forms for compliance with policy, and maintaining the associated records and files. HR is also responsible for consulting with the Legal Division (Legal) regarding the tax implications of academic assistance. As directed by HR, the Finance function (Finance) of the Management Division distributes academic assistance payments and collects any repayments.

Process Overview

While HR administers the program, the procedures for processing academic assistance involve employees and their division management as well as HR and Finance. Table 2 outlines the primary responsibilities that the employee, the employee's division, and HR and Finance have in the three major processes: (1) application approval and payment; (2) grade submission; and (3) repayment due to failing a course, withdrawing from a course, or leaving the Board. Exceptions or waivers are allowed for any section of the policy.

Table 2: Overview of the Current Academic Assistance Process

	EMPLOYEE	SUPERVISOR	HR	FINANCE
Application Approval and Payment	<ul style="list-style-type: none"> Completes academic assistance form Discusses with supervisor Signs form 	<ul style="list-style-type: none"> Determines if job-related and/or part of a degree program Checks past PMP Signs form 	<ul style="list-style-type: none"> Reviews form for completeness Determines if job-related and/or degree program Approves academic assistance Prepares request for disbursement 	<ul style="list-style-type: none"> Reviews form for appropriate signoffs Reviews total amount of academic assistance that employee has received Considers tax implications Pays employee
Grade Submission	<ul style="list-style-type: none"> Submits grade directly to HR 		<ul style="list-style-type: none"> Closes academic assistance file 	
Assistance Repayment	<ul style="list-style-type: none"> Fails course Withdraws from course Leaves Board within one year 		<ul style="list-style-type: none"> Prepares request for reimbursement 	<ul style="list-style-type: none"> Reviews and discusses repayment options with employee Receives payment by employee

HR uses an electronic database system known as REGISTRAR to track employees receiving academic assistance and to help manage the program. In addition to basic personnel information, REGISTRAR contains academic assistance data such as course titles, tuition amount, course start and end dates, and school(s) attended. REGISTRAR was recently upgraded to make it century date compliant and to provide additional functionality.

OBJECTIVES, SCOPE, AND METHODOLOGY

Prior to this audit, the HR Associate Director had asked us to work with him and his staff in assessing the structure and effectiveness of the Board's training and career development programs and to offer possible suggestions for improvement. As part of this partnership, we gathered preliminary information on the academic assistance program. While we found widespread support for the program, particularly in recruiting and retaining employees, we also found indications of internal control issues that warranted our further review.

As a result, we began an audit to assess the adequacy of internal controls over the Board's academic assistance program. More specifically, our objectives were to

- evaluate the goals and objectives of the academic assistance program;
- assess whether control procedures over the authorization and approval processes are sufficient to ensure that program policies and procedures are being properly and consistently applied in making academic assistance decisions;
- determine whether control procedures over the academic assistance payment and reimbursement processes ensure proper accounting and record keeping, achieve program objectives, and safeguard assets; and
- evaluate program compliance with applicable laws and regulations.

To accomplish these objectives, we focused on academic assistance provided during 1997 to obtain a full-year perspective of the program and 1998 (as of August 15, 1998) to gain a perspective of current procedures. We also gathered available statistical data for 1995 and 1996 to give us a more extended profile of academic assistance.

We conducted the audit from late July through September 1998. Through interviews with HR and Finance staff and reviews of applicable documentation, we charted the flow of information through the program and identified and analyzed key control points. We requested certain computer-generated data from HR and Finance and developed a spreadsheet to assist us in

analyzing and testing available data. Using data from this spreadsheet, we examined academic assistance application forms for completeness, evidence of control techniques, and consistency with reported data. We also interviewed attorneys from Legal regarding compliance with applicable rules and regulations.

As discussed in this report, the results of our assessment of the internal controls over the academic assistance program led us to qualify the computer-generated data that we obtained from HR's REGISTRAR system and Finance's internal reports. However, it is the best available information about the program, and we present it in this context in the report. We performed only limited verification of academic assistance expense data obtained from the Board's automated financial system and reported these data primarily for informational purposes. Our audit was conducted in accordance with generally accepted government auditing standards.

FINDINGS, CONCLUSIONS, AND RECOMMENDATIONS

Overall, we found that the Board's academic assistance program lacks an effective system of internal controls. Because controls are either weak or absent, the Board has little assurance that the program achieves its objective of providing financial assistance for Board-related courses to enhance employee work performance and career development, complies with applicable laws and regulations, and expends funds for the intended purpose and in accordance with Board policy. We have designated an estimated \$409,000, or just over 50 percent of the academic assistance funds expended during 1997 and through August 1998, as questioned costs, because we believe that tax determinations for these amounts may not have been consistent with federal internal revenue laws and regulations.

While we did not identify specific instances of fraud and abuse, management should not rely on the current system to prevent, detect, or correct errors or irregularities. More specifically, we found that internal controls are insufficient to ensure that

- academic assistance is authorized and approved in a consistent manner and in compliance with laws, regulations, and Board policy;
- applications and related documents are processed consistent with Board policy and maintained in an accurate, logical, and up-to-date record-keeping system;
- exceptions to program policies are clearly documented and consistently granted;
- academic assistance payments and reimbursements are consistent with policies and procedures; and

- management has the information needed to properly review, track, and monitor the program.

Problems with the academic assistance program have been known for some time; internal reviews performed in the early 1980s described internal control weaknesses that continue to exist today. While the changes that HR made in response to past reviews may have resulted in short-term improvements, they were insufficient to ensure that the program achieved its objectives over the longer term in a well-controlled manner. The HR Associate Director has begun taking steps to strengthen controls in some areas; however, sustained management oversight and supervision will be needed to provide an effective and efficient internal control framework for the Board's academic assistance program.

To establish this framework, our report recommends that the program first be brought into compliance with federal internal revenue laws and regulations by performing a case-by-case review of academic assistance payments to determine their taxability. The next eight recommendations address more specific controls over the approval, processing, and reporting/reconciliation processes. Our final recommendation focuses on defining and communicating clear lines of authority and responsibilities; establishing internal operating procedures; and providing sustained oversight, supervision, and training to ensure that policies and procedures are effectively implemented.

1. We recommend that the General Counsel and Director of the Management Division conduct a joint, case-by-case review of the academic assistance currently being provided to bring the program into compliance with federal internal revenue laws and regulations.

While the Board can prescribe the level of academic assistance it will provide employees and the types of courses and degree programs it will support, it must comply with internal revenue laws and regulations in determining the taxability of the assistance provided. As discussed below, our audit and an internal review by Legal show that the Board has not implemented the policies and procedures needed to bring its academic assistance program into full compliance with internal revenue laws and regulations.

Sections 127 (*Educational assistance programs*) and 162 (*Trade or business expenses*) of the Internal Revenue Code apply to the Board's academic assistance program and contain specific provisions regarding the taxability of educational expenses. Section 162 and its implementing regulation as they apply to academic assistance have not changed materially since 1967. On the other hand, Congress has allowed section 127 to expire and then be reinstated several times over the past few years, most recently by the Taxpayer Relief Act of 1997, enacted August 5, 1997. Table 3 below highlights the current distinctions between these two sections.

Table 3: Overview of Sections 127 and 162 of the Internal Revenue Code

Provision/Requirement	Section 127	Section 162
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Primary focus.	Educational assistance programs	Trade or business expenses
Annual dollar limit on tax Exclusion.	Up to \$5,250 per employee	No limit
Written plan is required.	Yes	No
Course-by-course evaluation and determination are required.	Yes	Yes
Undergraduate course assistance can be tax-exempt.	Yes (up to \$5,250 limit)	Yes (if it meets certain criteria)
Graduate-level course assistance can be tax-exempt.	No	Yes (if it meets certain criteria)
Courses must be strictly job-related to be tax-exempt.	No	Yes
Courses must NOT qualify the employee for a new trade or business to be tax-exempt.	No	Yes

As part of an internal evaluation of the Board's benefits programs, Legal reviewed the academic assistance program and raised questions about its compliance with sections 127 and 162. In a January 7, 1997, memorandum, the General Counsel informed the then-Director of the Division of Human Resources Management that the Board was out of compliance with section 127 because its academic assistance plan did not

- limit assistance to \$5,250 per employee per year;
- exclude assistance for courses leading to an advanced professional degree;⁴ and
- meet the documentation requirement for educational assistance programs, which includes completing a Form 5500 (*Annual Return/Report of Employee Benefit Plan*) and filing it with the Internal Revenue Service (IRS).

In response, the Management Division sent an explanatory letter to the IRS in March 1998 and filed past Form 5500s; it also amended its academic assistance plan in April 1998 to reflect the requirements of section 127.

While these actions are positive steps to bring the program into compliance with section 127, Legal's memorandum and our more recent analysis of the academic assistance program raise

⁴ Explanatory information from the Internal Revenue Service notes that educational assistance covered by section 127 does not include any payment for, or the provision of, any benefits for any graduate level course that is normally taken by an individual pursuing a program leading to a law, business, medical, or other advanced academic or professional degree.

further questions about the Board's compliance with other provisions of the tax code. In the January 1997 memorandum, Legal explained that in addition to providing academic assistance under section 127, the Board might also provide academic assistance under section 162. To qualify for tax exclusion under section 162 (as a "working condition fringe benefit"), educational assistance must be for courses that maintain or improve skills required for the employee's current position or meet express requirements for retaining the employee's current salary, status, or position (that is, be strictly job-related). In addition, payments for courses that meet the minimum educational requirements of the employee's position or are part of a program of study that could qualify the employee for a "new trade or business" must be included in the employee's taxable wages under section 162. The Board's policies and procedures do not ensure compliance with these provisions.

Legal reviewed selected academic assistance program files and concluded that many, if not most, of the courses approved for reimbursements were not job-related. While section 127 would allow the Board to exclude from taxes up to \$5,250 for undergraduate courses regardless of whether the courses are job-related, assistance provided for any undergraduate courses beyond the \$5,250—and any graduate-level courses—should be carefully analyzed to determine if the course is strictly related to the employee's current job. Legal observed that ". . . if the Board intended to comply with section 162, it would have to be withholding income taxes on the amounts it reimbursed to employees for courses that are not job-related." HR does not have criteria or procedures in place to consistently determine if each course deemed nontaxable under section 162 actually meets the test of being strictly "job-related."

In addition, the Board is out of compliance with the provision of section 162 regarding education that qualifies employees for a new trade or business. In our view, the academic assistance application form (see figure 2) itself prompts noncompliance with this provision. While the form requires supervisors to justify a course by commenting on how it relates to the employee's current duties, it goes a step further and asks for details on how the course will equip the employee to assume higher duties in his or her field. Our review of laws, regulations, and relevant cases leads us to conclude that academic assistance equipping employees to assume higher duties in their current field could be construed as qualifying them for a new trade or business and therefore could be taxable under section 162.⁵

Figure 2: Application for Academic Assistance

⁵Of course, if such a course qualifies for treatment under section 127, the assistance would not be taxable income for the employee, but would count against that employee's \$5,250-per-year limitation for tax-exempt assistance.

Application for Academic Assistance

Board of Governors
of the Federal Reserve System
Division of Human Resources Management

For office use only
Non-taxable _____
Taxable _____

(Must be submitted to Training and Development at least 15 working days before registration.)

Name (last, first, mi)	Stop	Social Security Number
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Division	Section
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Position Title	Entrance on Duty	Extension
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School or Institute	School Location
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Course No.	Course Title	Credit Hours	Dates (Mo/Yr) From To	Class Hour	Class Days	Cost of Course
						\$
Course No.	Course Title	Credit Hours	Dates (Mo/Yr) From To	Class Hour	Class Days	Cost of Course
						\$

To be completed by Applicant: In order for the Board to ensure compliance with applicable tax laws governing educational assistance programs, you must specify whether you are enrolled in a degree program. ☐ Yes ☐ No

If yes, please indicate degree: ☐ Associates ☐ Undergraduate ☐ Masters ☐ Ph.D.
☐ Other (please specify) _____

Major _____ Estimated degree completion date _____

Please indicate any prior degree(s): ☐ Associates ☐ Undergraduate ☐ Masters ☐ Ph.D.
☐ Other _____ and Major _____

- I have read and understand the terms and conditions of the Academic Assistance policy (obtain copy of policy from HRM or your division Administrative Assistant)
- How does this course(s) relate to your current job assignment and/or another job at the Board?

Lab Fees
Registration Fees
Other fees/specify
TOTAL
\$

Applicant's Signature _____ Date _____

To be completed by Supervisor: How does this study directly relate to the current work of the applicant or equip him/her to assume higher level duties in his/her field?

The applicant has a rating of "satisfactory" or above on his/her most recent PMP. ☐ Yes ☐ No

Charge To:	Comments	Supervisor Approval	Date
Cost Center		Division Approval	Date
Accounting Classification		HRM Approval	Date

FR 177 (10/95)

Legal's discussion of section 162 in a September 29, 1997, memorandum to the previous HR management supports this conclusion. According to Legal, "All assistance provided to employees without a college degree, for courses leading to a college degree, would qualify such employees for a new trade or business and, therefore, would not qualify for favorable tax treatment under section 162. The same principle holds true for courses that would lead to a graduate degree (provided to individuals without a graduate degree). Courses that improve or maintain the skills an employee needs for his current position or that are needed to meet the express requirements of the employee's job would receive favorable tax treatment under section 162." Legal also informed HR that it should coordinate with Finance to ensure that the Board withholds income taxes when required. According to Legal, "If the Board does not withhold taxes as required by law, it is liable for the payment of the taxes, regardless of whether the tax is paid by the employee."⁶ Legal added, "Once the tax has been paid by the employee, the Board is not liable for the tax, but may be subject to other penalties."

Both sections 127 and 162 require a case-by-case and course-by-course analysis to determine if the academic assistance being provided qualifies for favorable tax treatment under either section. During the course of our audit, we found confusion over who was accountable and responsible for making tax decisions regarding academic assistance and how the Board would ensure consistent interpretation of which courses are "job-related" and the associated taxability determination. We also found that HR does not consistently perform the case-by-case or course-by-course review required by internal revenue laws and regulations, particularly when considering degree programs. According to Finance staff, taxability determinations are based on whether HR determines that the degree program being pursued by an employee is job-related, not whether each individual course is strictly related to the employee's current job. The HR program manager and administrator told us that they rely on Finance to make taxability decisions.

Because of unclear accountability and responsibility for making tax decisions, confusion in interpreting and applying provisions of the tax code, potential problems with the form, and the absence of a case-by-case and course-by-course analysis, the Board's academic assistance program does not fully comply with internal revenue laws and regulations. We are particularly concerned about compliance with section 162, since HR records indicate that a substantial amount of academic assistance supports advanced degree programs, which fall outside of the general tax exemption provided by section 127. As shown in table 4, the best available data that we obtained as a result of matching HR's REGISTRAR system against Finance's data indicate that the Board provided about \$432,000 in academic assistance during 1997 and 1998 (as of August 15, 1998) for graduate-level courses specifically related to advanced degree programs and treated as tax-exempt about \$409,000, or just over fifty percent of the Board's total academic assistance expenditures during that period. Accordingly, we are designating the \$409,000 in academic assistance paid in 1997 and through August 15, 1998, as questioned costs, because we believe that determinations with respect to the taxability of these amounts may not have been consistent with the federal internal revenue laws.⁷ We included amounts for 1998, even though the Board

⁶26 C.F.R. § 31.3403-1, 31.3402 (d) - 1.

⁷Section 5 of the Inspector General Act, as amended, defines "questioned cost" as a cost that is questioned by the Office of Inspector General because of (1) an alleged violation of a provision of a law, regulation, contract, grant, cooperative agreement, or

may still have time to consider our recommendation with respect to 1998 benefits. In our opinion, it is likely that similar circumstances existed in prior years.

Table 4: Academic Assistance for Graduate Courses Related to Advanced Degree Programs, 1997 and 1998

Year	Number of Advanced Degree Candidates	Academic Assistance Provided	Number of Advanced Degrees Taxed	Assistance Subjected to Tax Withholding	Value of Tax-Exempt Assistance
1997	63	\$232,582	3	\$22,840	\$209,742
1998	52	\$199,176	1	\$90 ⁸	\$199,086
Total	— ⁹	\$431,758	4	\$22,930	\$408,828

We believe that the Director of the Management Division and the General Counsel should work together to resolve issues surrounding the Board's noncompliance with internal revenue laws and regulations as they relate to the taxability of academic assistance. This effort should include a case-by-case review of academic assistance currently being provided (and for any other periods of time as determined by the Management Division in consultation with Legal), as well as an analysis of existing policies and procedures that need to be revised to bring the academic assistance program into full compliance with internal revenue laws and regulations.

- 2. We recommend that the Director of the Management Division, in consultation with the General Counsel, redesign the academic assistance application form so that it (a) captures the information needed to make appropriate taxability decisions and (b) informs applicants and approving officials of their responsibilities.**

The academic assistance application form (see figure 2, page 11) initiates the academic assistance process and is used throughout the process to document various actions. While the current application form gathers basic information, its format and content need to be improved. For example, the current form appears to lead the supervisor to provide information that could result in an inappropriate income tax determination to the employee. We believe that it would be more

other agreement or document governing the expenditure of funds; (2) a finding that, at the time of the audit, such cost is not supported by adequate documentation; or (3) a finding that the expenditure of funds for the intended purpose is unnecessary or unreasonable.

⁸We also observed that this \$90 in academic assistance appears to have been subjected to withholding during 1998 because it exceeded the \$5,250 threshold of section 127 even though the section 127 exclusion automatically does not apply to graduate-level courses. Such courses should be tested against section 162 only.

⁹ We did not total this column because the 1998 numbers include 1997 candidates who continued to participate in 1998.

useful if the Management Division, in consultation with Legal, redesigned the form to collect information needed to make appropriate tax decisions and to provide supervisors more information on their responsibilities in approving the form. For example, information should be captured to assist in determining whether a course is job-related and whether the course will qualify the employee for a new trade of business.

In addition, we believe that the form should be improved to provide applicants more information on their responsibilities. For example, the current form requires applicants to acknowledge that they have read and understood the terms and conditions of the academic assistance policy. We believe that the form would be more effective if it required applicants to specifically acknowledge that they

- are not receiving assistance from any other source, such as the Veterans Administration or scholarships;
- need to resubmit the form if they change from the approved course;
- must submit a grade or other evidence of satisfactory completion within a certain time frame after the course is complete;
- will not receive further assistance until the grade and any other documentation requirements have been met for all prior assistance;
- authorize payroll deductions for amounts that they owe the Board as a result of not submitting proper documentation within the specified time frame; and
- agree in writing to reimburse the Board for all the course expenses and/or examination fees for a grading period if they separate from the Board before completing a course or within one year after completing a course or receiving professional certification (unless an exception is formally requested and granted).

3. We recommend that the Director of the Management Division revise the “Academic Assistance Policy” statement to require that (a) changes from approved courses be

reapproved and (b) participants promptly submit a receipt from the educational institution for tuition and fees.

The “Academic Assistance Policy” is currently silent regarding the proper way to handle changes from approved courses. During our review of completed applications, we found instances where courses listed on the original application were crossed out and different course titles were added, without any explanation for the changes or any signatures of the applicants or their supervisors. The program administrator told us that she makes these changes when participants try to register for a course, only to find that it is full or has been dropped from the schedule. However, because the policy does not require a receipt listing the course attended and the associated costs, the program administrator may not learn of the change until the participant submits final grades.

We believe that if the employee deviates from the original course selection, the academic assistance policy should require that the new course go back through the approval process. This review would ensure that the supervisor is aware of the employee’s academic progress, that the course is related to the employee’s job or other training or degree program in which the employee is currently enrolled, and that any changes are properly documented and reassessed for taxability. In addition, we believe that requiring employees to submit course receipt(s) from the educational institution after they have registered and paid for the course(s) should strengthen the policy. This procedure would provide the Board with some assurance that the employee did in fact register at the intended educational institution for the approved course and the dollar amount provided.

4. We recommend that the HR Associate Director establish a logical and complete record keeping and filing system.

A variety of documents are used in administering the academic assistance program, including the application forms, grades, and other documents. Under the Board’s *Record Policy and Procedures Manual*, these records must be filed in a way that makes them easily retrievable and available to staff members who need them to conduct Board business. In addition, a clear and logical filing system would also facilitate tracing academic assistance dollars from division approval, through processing, to final payment or collection of any reimbursements due. Any changes, waivers, or exceptions to the standard process should also be documented and explained. Maintaining accurate and complete records allows the Board to ensure that academic assistance decisions and other actions consistently comply with policies, laws, and regulations.

HR’s existing filing system did not allow us to readily determine the status of academic assistance provided to program participants. Currently, both HR and Finance keep separate files on academic assistance, and neither file provides a complete record of key events or decisions. HR relies primarily on information in the REGISTRAR to track the status of

academic assistance; however, this database does not include information on any changes, waivers, or exceptions; any tax-related decisions or information; any amounts billed employees and the related justification; or any description of amounts collected or the final resolution of the academic assistance account. When we attempted to augment the REGISTRAR information with hard copy documentation, we found that individual records were typically dispersed across different files and were not easily located. For example, if an employee had not yet submitted a grade to evidence course completion, the copy of the related application form would be filed *by year* along with other application forms meeting the same criteria. Once grades were received, the copy of the application and the supporting grades were filed *by participant*. The participant's original application form was maintained in Finance, as part of the payroll files.

To establish a logical and complete record-keeping and filing system that is consistent with the Board's *Record Policy and Procedures Manual*, we believe that HR should first determine what information it must collect to properly administer the Board's academic assistance program according to Board policy and applicable laws and regulations. The Management Division should then create a centralized filing system where records are easily accessible to appropriate HR and Finance staff members. A checklist may also be useful to identify the data that need to be collected and tracked.

- 5. We recommend that the Director of the Management Division (a) revise the “Academic Assistance Policy” to require that grade reports be submitted within a specific period from course completion, (b) establish procedures to track the status of grade submissions, (c) require that grades be on file as a prerequisite for receiving further academic assistance, and (d) enforce the reimbursement requirements for outstanding grades.**

The Board requires that employees receiving academic assistance satisfactorily complete courses taken under the program and relies on the submission of grades or other certificates of completion to meet this requirement. Obtaining grades or other evidence of satisfactory course completion has been a recurring problem dating back to the early 1980s. Shortly after we began the audit, the HR Associate Director recognized that this problem could still be occurring and asked his staff to create an *Outstanding Grade Report* from the REGISTRAR system for 1995 through 1997.

The first report, dated August 5, 1998, showed that 123 employees who received \$327,627 in academic assistance had not submitted grade reports for 329 courses taken between 1995 and 1998. In addition, many of these employees continued to receive academic assistance, even though they were not submitting evidence that previous courses had been satisfactorily completed. Without grades or other certificates of completion, the Board has no assurance or documented support that the academic assistance dollars were being used for legitimate purposes. Because some of the courses date back to 1995 and the employees who took them have since left the Board, HR may have some difficulty clearing these accounts.

Upon receiving the initial report, the HR Associate Director instructed his staff to immediately collect the grades and met with the staff on a frequent basis to assess their progress. HR staff told

us that through a concerted effort, they were able to resolve a substantial number of the grades, and the *Outstanding Grade Report* dated September 15, 1998, shows significant progress. According to that report, grades from 43 employees had not yet been submitted for a total of \$71,955 in academic assistance. Given the ongoing status of the collection effort and the condition of the associated files at the time of our review, we did not attempt to verify the grades received against the report.

We believe that correcting this long-standing problem will take a four-pronged approach of clarifying the policy, implementing procedures to track the status of grade submissions, withholding further assistance until grades are submitted, and enforcing reimbursement requirements. First, we believe that the “Academic Assistance Policy” should be revised so that the due date for grades or other certification of course completion is clearly communicated. The “Academic Assistance Policy” currently states, “An employee must submit a grade report or other certification of completion to the Training and Development Section in the Management Division within one month of *receipt* [emphasis added].” We believe that the policy would be clearer, and compliance easier to measure, if the policy statement were revised to require grades within a specific period (e.g., 30 days) of *course completion*.

Second, HR must have an efficient and effective process for identifying and collecting outstanding grades on a timely basis. The current process relies heavily on manual intervention by the program administrator to identify who has not submitted grades and does not include any cross-checks to ensure that outstanding grades are handled according to policy. REGISTRAR does not currently highlight grades that are due nor provide a record that shows what actions have been taken to collect them. Without clear internal procedures, it will be difficult to track the status of grade submissions and the associated corrective action.

The remaining two parts of our suggested four-pronged approach focus on strengthening the consequences for failing to comply. The “Academic Assistance Policy” places the responsibility for submitting grades or other evidence of completion squarely on the employee. If an employee does not submit grades according to the policy, we believe that the employee should not receive further assistance until the outstanding grades have been submitted. If this action fails, we believe that the Director of the Management Division should promptly enforce the reimbursement policy, which includes appropriate payroll deductions for courses that have no evidence of satisfactory completion.

6. **We recommend that the Director of the Management Division establish controls to ensure that (a) HR enforces the reimbursement policy for departing employees and promptly notifies Finance of amounts due and (b) Finance periodically reports back to HR on collection status.**

The “Academic Assistance Policy” requires that “employees who separate from the Board before completing a course, or within one year of completing a course or receiving professional certification, must reimburse the Board for all the course expenses and/or examination fees for that grading period.” HR is responsible for ensuring that departing employees have met this requirement.

We found that the current process does not include sufficient controls to ensure that amounts due are properly identified, tracked, and collected. For example, the process relies on the program administrator to manually compare a list of departing employees to REGISTRAR data to identify employees who have received academic assistance and to manually determine any amounts due. Because of the weak control environment, the data in REGISTRAR are often inaccurate or incomplete. Even if the proper amounts are identified, they must be communicated to Finance for collection. Unless they are specifically notified by the program administrator, Finance staff assume that the separating employee has no outstanding debt. In addition, Finance does not report back to HR on the status of collections, and HR does not formally close the accounts.

The lack of sufficient controls over this process and the absence of a clear and consistent audit trail make it difficult to assess the status of academic assistance reimbursements from departing employees. At a minimum, we observed that the August 5, 1998, *Outstanding Grade Report*, discussed in recommendation 5 (see page 16), includes 23 employees who apparently had left the Board without submitting evidence of course completion or reimbursing the Board for incomplete course work totaling \$50,890, according to HR records.

To avoid these problems in the future, we believe that HR and Finance should work together to ensure that departing employees promptly resolve their academic assistance accounts. By sharing and reconciling information on amounts due and the status of repayments or payroll deductions, we believe that HR can better ensure compliance with Board policy.

7. We recommend that the Director of the Management Division revise the “Academic Assistance Policy” to include the criteria and associated process for granting exceptions or waivers to program requirements.

The current “Academic Assistance Policy” requires that any requests for exceptions to the policy must be made in writing to “the Training and Development Section of the Management Division” and must be signed by the employee’s supervisor and division director (or the director’s designee). It also states that the requests for exceptions will be considered in light of the needs of, and benefit to, the Board. The April 1998 revision to the policy added that no exceptions could be made regarding the requirements of section 127 of the Internal Revenue Code. The policy is also clear that employees who separate from the Board but transfer to a Reserve Bank are exempt from the reimbursement requirement. In addition, the policy states that the Staff Director for Management may waive the requirement for reimbursement, citing

as examples a temporary employee whose appointment expires without an offer of regular employment or in the case of a reduction in force.

In practice, however, we found that numerous waivers have been granted for situations that go well beyond those specified in the Board's policy. According to the academic assistance program manager, waivers generally have been granted for very specific reasons, including medical emergency, disability retirement, financial hardship (loss of income), and management-initiated job abolishment. In addition, Research Assistants who leave the Board to return to full-time academic study may be granted waivers. Another common waiver is granted for employees who enroll in compressed degree programs or who exceed the standard number of courses that can be taken in a year. These exceptions are not documented in the policy, and it is generally up to the employee to research these exceptions and request a waiver. The policy also states that employees may appeal decisions made under this policy by following the procedures outlined in the "Adjusting Work-Related Problems Policy."

While the "Academic Assistance Policy" contains some guidance on the exception process, it does not include all exceptions and does not identify who has authority to grant waivers, what criteria will be used, or what procedure will be followed. For example, the policy does not provide a time frame for receiving waivers, discuss how decisions will be documented and reviewed, or outline how results will be communicated to the employee and supervisor. Because authority, criteria, and policies are unclear, the Board has no assurance that it is consistently handling exception requests.

We requested exception files from the academic assistance program administrator for 1997 and 1998. Our review of the 11 exceptions granted in 1997 showed that two had no documentation of supervisor/division director approval, one had no documentation of HR approval, and one exception had no documentation at all. Of the three exceptions granted to date in 1998, one clearly documents HR's denial of the exception; however, it was later granted without any further documentation. These exception files do not contain any documentation of waivers granted for the number of courses taken in a given time frame or for Research Assistants returning to school. Also, there are no consistent files on the exceptions requested and subsequently denied.

We believe that the "Academic Assistance Policy" should be revised to include the criteria for granting an exception to the reimbursement requirements. We understand that such a list could not be all-inclusive, but it should be expanded to give employees a general idea of the situations that the Board will consider for waiving reimbursement requirements. We also believe that the policy should provide employees more guidance by outlining the general exception review process and who is responsible for granting waivers.

8. **We recommend that the Director of the Management Division identify the reports needed to (a) review, track, and manage the program and (b) verify that controls work as intended.**

Reports containing operational, financial, and compliance-related information are useful tools in effective program management and control, and regular reporting helps management review and track the program and verify that controls are working as intended. We found that HR does not regularly generate any management reports on the academic assistance program. While the REGISTRAR system has a reporting capability, HR uses it only on an ad hoc basis. For example, the *Outstanding Grade Report* discussed in recommendation 5 (see page 16) was generated in response to a special request by the HR Associate Director. With ongoing management attention and follow-up, the associate director was able to use this report as one tool for tracking progress in obtaining outstanding grades.

We believe that the Director of the Management Division should identify the reports needed to review, track, and manage the program and then ensure that these reports are produced on a regular basis. From a control perspective, the director may consider obtaining regular reports to highlight employees who have not yet submitted grades or employees who are leaving the Board and the corresponding courses completed within the last year for which repayment may be warranted. Certain reports could be used to highlight exceptions to the program, such as employees who have been in the program more than a certain number of years or employees who have attended more than a certain number of courses. A year-end report not only would serve to document transactions throughout the year but also would assist in a reconciliation process, as discussed in the next recommendation.

Other reports may be useful in assessing the program's success in achieving its objectives. For example, it would be useful to track information, such as the number of employees participating in the program, their job/grade levels, and how long they stayed at the Board after obtaining a degree. We also believe it would be beneficial for the Management Division to periodically report to Board directors and managers regarding academic assistance provided to division employees. In addition to providing a level of external verification of HR data, such a report would also inform management about HR support.

Of course, an effective internal control system is a prerequisite to producing accurate and reliable reports. Once the Management Division has implemented a strong internal control system, we believe that it then may want to look at new ways to use information technology to better meet its reporting needs.

9. We recommend that the Director of the Management Division establish a process to regularly reconcile Finance's records of academic assistance payments and reimbursements with HR's academic assistance records.

As described earlier, the procedure for processing academic assistance is currently divided between HR and Finance, with HR responsible for processing and approving the applications for academic assistance and Finance responsible for the actual payment to the employee. For example, upon final approval of an academic assistance application form, HR enters the information into REGISTRAR, makes a copy of the application for its files, and sends the original

application form and a request for tuition disbursement to Finance. Finance is then responsible for disbursing the funds to the employee. This process is generally repeated when employees submit textbook reimbursement requests. A similar process also occurs when an employee drops or fails a course or leaves the Board within one year of finishing a course. In these cases, HR informs Finance to seek reimbursement from the employee.

For 1997, we found that the tuition and book expenses included in the Board's year-end financial statements were not reconciled with internal Finance expense records and that HR did not produce year-end tuition and book expense reports from REGISTRAR. While we do not believe that this lack of reconciliation had a material effect on the financial statements, it could result in errors and omissions in transaction processing going undetected and uncorrected, with decisions being made on erroneous information. We understand that in 1998 Finance discontinued its internal reports and now uses the Board's new payroll system to disburse academic assistance funds.

During our review, we found discrepancies between HR and Finance data regarding the amounts of academic assistance provided to participants for specific courses. For the 175 participants that HR identified as receiving academic assistance during 1997, we compared the dollars spent on courses as recorded in REGISTRAR with the amounts recorded in the internal Finance expense records and found 133 discrepancies, ranging from \$.02 to \$5,244.00. We did the same comparison for the 125 participants in 1998 (through August 15, 1998) between data from REGISTRAR and the new payroll system and found 76 discrepancies, ranging from \$.01 to \$3,775.00.

We believe that HR should develop, at a minimum, a year-end report showing tuition and book expenses (see recommendation 8, page 19) and that this report should be reconciled with the Board's year-end financial statement expenses for those accounts. This process would ensure that errors and omissions are quickly detected and would provide the Management Division with reasonable assurance that recorded balances in both systems are correct.

10. We recommend that the Director of the Management Division (a) define and communicate clear lines of authority and responsibility; (b) develop internal operating policies and procedures; and (c) provide sustained oversight, supervision, and training to ensure that policies and procedures are effectively implemented.

An effective internal control framework requires sustained management commitment and support, and we believe that three areas need attention. First, the lines of authority and responsibility for the academic assistance program should be clearly defined and communicated. While the HR Associate Director has the delegated authority and responsibility to "contract for academic assistance and training courses in accordance with the Board's policy and procedures on acquisition" and is responsible for administering and implementing the "Academic Assistance Policy," we found confusion regarding who had the authority and responsibility for making certain decisions. For example, as indicated in recommendation 1 (see page 8), we found confusion over

who was accountable and responsible for making tax decisions regarding academic assistance, including whether or not a course is “job-related.”

The policy is silent on the roles and responsibilities for handling any changes from approved courses (see recommendation 3, page 14) and is also unclear regarding who has the authority and responsibility to grant waivers or exceptions to the academic assistance policy (see recommendation 7, page 18). References to the roles and responsibilities of division management and employees appear throughout the “Academic Assistance Policy,” and we believe that clearly defining and communicating them in one section of the policy statement would help clarify expectations for the managers who approve and the employees who receive academic assistance.

Second, academic assistance applications, payments, and collections should be processed in accordance with the Board’s policy and on a timely basis. We found that HR does not have written internal policies and procedures for managing the day-to-day administration of the academic assistance program, including its coordination with Finance. Without internal operating policies and procedures, HR lacks a basic control for ensuring that the program functions efficiently and effectively and complies with the Board’s “Academic Assistance Policy” and applicable laws and regulations.

Finally, providing sustained oversight, supervision, and training to ensure that policies and procedures are effectively implemented should be part of the academic assistance control environment. We found little evidence of sustained management oversight and supervision. Many of the internal control deficiencies found in the 1980 internal reviews of the academic assistance program exist today, particularly in the areas of obtaining evidence of satisfactory course completion, resolving reimbursements due from departing employees, and providing documented waivers or exceptions to the program. As discussed in recommendation 8 (see page 19), HR management does not receive any regular reports to facilitate supervisory review and monitoring. We found that HR essentially relies on one employee to administer the program on a day-to-day basis and that no one has been properly authorized or trained to provide appropriate backup.

ANALYSIS OF COMMENTS

We provided a copy of this report to the Staff Director for Management for review and comment, and include his response as appendix 1 to this report (see page 27). Because recommendations 1 and 2 also involved the Legal Division, we also provided a copy of the report to the General Counsel for formal comment and have included his response as appendix 2 (see page 31). Both responses indicate general agreement with the recommendations and discuss actions that have or will be taken to implement them.

The staff director’s response indicates that the Management Division expects to fully implement changes that respond to each of the ten recommendations no later than April 1, 1999, with the possible exception of changes to, or replacement of, the current automated tracking system should that prove necessary. The staff director also outlines steps that are being taken in coordination with the Legal Division to bring the program into compliance with federal internal revenue laws

and regulations, including revising the Board's "Academic Assistance Policy."

The General Counsel's response also notes that the Legal Division has been working with the Management Division and has identified situations involving taxable income for 1998, which the Management Division is endeavoring to resolve. The General Counsel adds that the Legal Division is considering how to resolve any pre-1998 taxability issues that may arise and is continuing to work with the Management Division in revising the academic assistance plan and forms.


APPENDIXES

Appendix 1 – Staff Director for Management’s Comments

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Office Correspondence

MANAGEMENT DIVISION

DATE: February 2, 1999
TO: Office of Inspector General
FROM: S. David Frost 
SUBJECT: Response to Audit Recommendations

We appreciate the opportunity to respond to the recommendations provided by the Inspector General in the *Report on the Audit of the Board's Academic Assistance Program*. As indicated in the attachment, we concur with all the recommendations provided in the report. We expect full implementation of these changes no later than April 1, 1999, with the possible exception of changes to or replacement of the current automated tracking system should that be necessary.

We commend the Inspector General and his staff for the collaborative approach to this audit. All activities were well coordinated with the Management Division, and resulted in recommendations that once properly implemented, will ensure compliance with applicable tax laws and a properly administered program.

Attachment

Appendix 1 – Staff Director for Management’s Comments

Response to Recommendations

1. We recommend that the General Counsel and Director of the Management Division conduct a joint, case-by-case review of the academic assistance currently being provided to bring the program into compliance with federal internal revenue laws and regulations.

Concur. Steps have been taken to ensure compliance with federal internal revenue laws and regulations. The Management Division has reviewed all 1998 payments and 1999 applications for graduate level courses and, in consultation with the Legal Division, has determined the appropriate tax treatment. Appropriate adjustments have been made where necessary. Further, all payments for undergraduate level courses for the same period were similarly reviewed and adjusted by the Management Division. Actions are also underway to revise the Board’s Academic Assistance Policy to treat virtually all assistance as taxable, except where exclusions can be made for undergraduate level courses consistent with Section 127 of the Internal Revenue Code. Management Division staff is continuing to discuss with the Legal Division what actions might be appropriate for the treatment of preceding years academic assistance.

2. We recommend that the Director of the Management Division, in consultation with the General Counsel, redesign the academic assistance application form so that it: (a) captures the information needed to make appropriate taxability decisions, and (b) informs applicants and approving officials of their responsibilities.

Concur. Action is currently underway to redesign the application form. The final design of the application must reflect the provisions and requirements of the Academic Assistance Policy, which also is being revised.

3. We recommend that the Director of the Management Division revise the *Academic Assistance Policy* statement to require that: (a) changes from approved courses be reapproved, and (b) participants promptly submit a receipt from the educational institution for tuition and fees.

Concur. As indicated above, the Management Division is working with the Legal Division to revise the policy. We agree with the IG’s recommendation that the revised policy should require reapproval of changes to approved courses, and that receipts for tuition and fees should be submitted to support the expenditure of Board funds.

Appendix 1 – Staff Director for Management’s Comments

4. We recommend that the HR Associate Director establish a logical and complete recordkeeping and filing system.

Concur. We will closely examine the current recordkeeping systems, including software, to determine if they satisfy our information requirements, are consistent with the Board's recordkeeping guidelines, and support fully our goals and objectives in administering this program. If the systems are found to be deficient, we will act promptly to replace them. Further, we will ensure that our operating procedures are appropriate and applied consistently.

5. We recommend that the Director of the Management Division: (a) revise the *Academic Assistance Policy* to require that grade reports be submitted within a specific period from course completion, (b) establish procedures to track the status of grade submissions, (c) require that grades be on file as a prerequisite for receiving further academic assistance, and (d) enforce the reimbursement requirements for outstanding grades.

Concur. The revised Academic Assistance Policy will appropriately address the four areas identified as items (a) through (d) above.

6. We recommend that the Director of the Management Division establish controls to ensure that: (a) HR enforces the reimbursement policy for departing employees and promptly notifies Finance of amounts due, and (b) Finance periodically reports back to HR on collection status.

Concur. The Director of the Management Division has directed the Associate Directors of Human Resources and Finance to develop and implement such controls and to ensure future compliance.

7. We recommend that the Director of the Management Division revise the *Academic Assistance Policy* to include the criteria and associated process for granting exceptions or waivers to program requirements.

Concur. The revised policy will clearly identify those circumstances under which exceptions or waivers may be granted consistent with applicable laws and regulations.

Appendix 1 – Staff Director for Management’s Comments

8. We recommend that the Director of the Management Division identify the reports needed to: (a) review, track, and manage the program, and (b) verify that controls work as intended.

Concur. The Associate Director, Human Resources, is in the process of identifying appropriate management reports.

9. We recommend that the Director of the Management Division establish a process to regularly reconcile Finance’s records of academic assistance payments and reimbursements with IIR’s academic assistance records.

Concur. Action will be taken by the Associate Directors of Human Resources and Finance to provide for such a reconciliation. Results will be documented and approved by appropriate management staff.

10. We recommend that the Director of the Management Division: (a) define and communicate clear lines of authority and responsibility, (b) develop internal operating policies and procedures, and (c) provide sustained oversight, supervision, and training to ensure that policies and procedures are effectively implemented.

Concur. The actions recommended by the IG are an integral part of a properly structured, administered, and controlled academic assistance program, and will be incorporated in the administrative procedures governing the program.

Appendix 2 – General Counsel's Comments

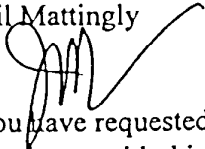
BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

February 1, 1999

To: Barry R. Snyder
Subject: Draft Report on the Audit of the
Board's Academic Assistance
Program (A9811)

From: J. Virgil Mattingly


You have requested Legal Division's further and final comments on the Draft Report. Consistent with this Report, we have been working with the Management Division to assist it in trying to resolve problems identified by the Inspector General.

My comments focus principally on Recommendation No. 1 and are consistent with what Mr. Ireland indicated in his memorandum of December 9, 1998. We continue to believe that certain classes of academic assistance decisions may prove to involve little or no risk of non-compliance such that a case-by-case review of individual decisions in the class should not be necessary. For example, it should not be necessary to review a particular decision in detail once it is determined that the decision clearly involves academic assistance for undergraduate courses.

We have been working with Management Division and have identified situations involving taxable income for 1998, which Management Division is endeavoring to resolve. In addition, we have under consideration the question of how far back in time this review should go and what specific steps need to be taken to resolve any pre-1998 taxability issues that may arise. Finally, we are currently working with Management Division on revisions to the academic assistance plan and forms (Recommendation No. 2).

Appendix 3 - Principal OIG Contributors to this Report

Beth Coleman, Senior Auditor and Auditor-in-Charge

Mike Green, Senior Auditor

Tony Castaldo, Senior Auditor

Aya Tanaka, Auditor

Nancy Perkins, Senior Auditor

Patty Kelley, Audit Manager

Harry Jorgenson, Counsel to the Inspector General